IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1944.

No.........

LOUIS STOCKSTROM,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

OPINIONS BELOW.

The opinion of the Tax Court (R. 87-95) is reported in 3 T. C. 255. The opinion of the Circuit Court of Appeals, including the concurring opinion of Judge Sanborn (R. 106-119), is not yet reported.

JURISDICTION.

The jurisdictional statement appears in the Petition for the Writ of Certiorari.

STATEMENT OF THE CASE.

Petitioner's statement of the case appears in the Petition for the Writ of Certiorari.

ARGUMENT.

I.

Conflict in the Opinions of the Circuit Courts of Appeals.

Commissioner of Internal Revenue v. Katz, 139 Fed. (2d) 102, is a decision by the Seventh Circuit refusing to tax trust income to the grantor-trustee. Katz was a successful businessman with income in excess of needs; his salary in 1937 was $48,000 and in 1938 more than $65,000. He executed four separate declarations of trust, one each for the benefit of his wife and their three children. The trust instruments gave him very broad administrative powers and as to income provided:

> "The trustee may, in his discretion, at any time and from time to time, withhold and accumulate any of the net income payable to any of the foregoing beneficiaries and/or apply any or all of such income for the benefit of such beneficiaries."

The Court of Appeals denied the Commissioner's contention that the case was within the **Clifford** doctrine saying:

> "We agree with the Board that the instant case is distinguishable from the Clifford case. True, there are some elements in common, most noticeable of which are the broad powers of management vested in the trustee. Such matters of similarity, however, are of little consequence and certainly not controlling when considered in connection with other provisions, which, in our judgment, clearly remove the instant situation from the rationale of the Clifford case. The trust in Clifford was of short duration, while in the instant case it is long term in character, having an indefinite and at all times unascertainable duration. Of course, the trust duration is not conclusive, but it is a significant circumstance. Retention by the grantor of economic benefit is more readily attributable in a trust

of short term duration. Under the circumstances of the Clifford case, conspicuous among which was a short term trust, the court concluded that there was 'but a temporary reallocation of income.' On the other hand, in the instant case both the income and corpus, due largely to the long term nature and indefinite existence of the trust, amount to a final disposal which may be characterized as permanent. In Clifford, the trust property was to be returned to the donor in a comparatively short period, while here it will never be returned, except on the contingency of revocation, hereinafter discussed in connection with Sec. 166."

In this case and the **Katz** case there was—(a) income in excess of needs, (b) a grantor-trustee, (c) a long term trust and permanent disposition of the property, (d) an intimate family relation, (e) broad administrative powers, and (f) power to distribute or accumulate income.

In **Commissioner v. Armour,** 125 Fed. (2d) 467, the Seventh Circuit Court of Appeals held that the grantor-trustee of a trust for her daughter was not liable for the tax on the trust income. There was the same factual similarity to this case as appears in the **Katz** case.

The case of **Phipps v. Commissioner**, 137 Fed. (2d) 141, is based on facts almost the same as the facts in the case of the children's trusts. The petitioner created a trust for his wife and child naming himself, a corporation, and his wife as trustees. After the child became twenty-one years old, the trustees were given the power, in their absolute discretion, to allocate income of the trust between petitioner's wife and child. The Tax Court held that as the petitioner dominated the corporate trustee, he could control distribution of the income, and, therefore, the doctrine of **Helvering v. Clifford,** 309 U. S. 331, was applicable. The decision of the Court of Appeals reversing the Tax Court is particularly important as the Court of Appeals

found that petitioner did control the corporate trustee and consequently had the same control as if he had been sole trustee. The Court said (l. c. 143):

> "Nevertheless, we cannot agree with The Tax Court that this case is like Commissioner v. Buck, 2 Cir., 120 F. 2d 775, or otherwise within the Clifford doctrine. The trust here is a long term trust, and, as we said in the Buck case, the control over the income exercised by the grantor must be 'very substantial' in such circumstances if the income is to be considered his. It may be argued that during the minority of the child, the taxpayer (operating through the trust company) could refuse to agree to the payment of any income to the wife, and that, if she, in turn, thereupon refused to agree to the payment of any income for the support and maintenance of the child, the income would accumulate and be paid to the child at the age of 21, with only a contingent possibility of the wife's receiving these accumulations (i. e., in the event that the child predeceased the wife before the child reached the age of 21). But, as the obvious purpose of the trust was that the wife was to receive a considerable part of the income, an arbitrary refusal on the part of her co-trustee to pay her any of the income so that it would accumulate, would, we think, induce the New York courts to interfere and compel the co-trustee to exercise a genuine discretion in the light of the purpose of the trust."

An arbitrary refusal by petitioner to distribute income of the trust for his children to a beneficiary in need of funds to maintain his or her accustomed standard of living, would undoubtedly induce the Missouri courts to interfere and compel petitioner to exercise a genuine discretion in allocating the income of the trusts among the beneficiaries. **Williams v. Hund**, 302 Mo. 451, 258 S. W. 703; **Plummer v. Brown,** 287 S. W. 316; **Mississippi Valley Trust Co. v. Buder,** 47 Fed. (2d) 507.

The similarity of the facts in the cases decided in favor of the taxpayer by the Second and Seventh Circuit Courts of Appeals with the facts in this case show a conflict in the decisions which ought to be resolved by this Court.

II.

Conflict With Decisions of This Court.

The decision also conflicts with the decision by this Court in **Helvering v. Stuart,** 317 U. S. 154, 602, 63 Sup. Ct. 140. The facts in the **John Stuart** case and in this case cannot be readily distinguished; the instruments and the circumstances were very much the same. The trusts created by John Stuart for his adult children provide that income of the trusts should for fifteen years be paid to the beneficiaries or accumulated as the trustees in the exercise of their absolute discretion might determine. After fifteen years the entire net income was to be paid to the beneficiaries for the balance of their lifetime. The distribution clauses in the **John Stuart** case and in this case are so similar that there does not appear to be any real difference between them in so far as control of income is concerned. The only other difference is that petitioner is sole trustee, while John Stuart was one of three trustees, the others being his wife and brother. When the fact is considered that the co-trustees in each **Stuart** case were the wife and brother of the grantor-petitioner and that the trustees of the two trusts interlocked, there is no real difference in this respect. This Court in response to the contention that Stuart's control over the trusts made him taxable under Section 22 (a), said:

> "In the John Stuart trusts the trustees, in their discretion, were to distribute income to the named beneficiaries for fifteen years and thereafter to distribute the entire net income. In the Douglas Stuart trusts, the directions authorized discretionary distribution to

the beneficiaries or its application to their education, support and maintenance until the children reached the age of twenty-five years. Undistributed portions of the income were to be added to the corpus. Plainly, these distributions or accumulations were to be used for the economic advantage of the children of the settlors and to the amount of these distributions and accumulations would satisfy the normal desire of a parent to make gifts to his children. Is this alone sufficient to make the income of the trusts taxable to the settlors?

"Disregarding for the moment the minority of some of the beneficiaries, we think not. So broad a basis would tax to a father the income of a simple trust with a disinterested trustee for the benefit of his adult child. No act of Congress manifests such an intention. Economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme. That gain need not be collected by the taxpayer. He may give away the right to receive it, as was done in **Helvering v. Horst,** 311 U. S. 112, 61 S. Ct. 144, 85 L. Ed. 75, 131 A. L. R. 655; **Helvering v. Eubank,** 311 U. S. 122, 125, 61 S. Ct. 149, 150, 85 L. Ed. 81, and **Harrison v. Schaffner,** 312 U. S. 579, 61 S. Ct. 759, 85 L. Ed. 1055. But the donor nevertheless had the 'use (realization) of his economic gain.' 311 U. S., at page 117, 61 S. Ct., at page 147, 85 L. Ed. 75, 131 A. L. R. 655. In none of the cases had the taxpayer really disposed of the res which produced the income. In **Corliss v. Bowers,** 281 U. S. 376, 50 S. Ct. 336, 74 L. Ed. 916, he had disposed of the res, but with a power to revoke at any moment. This right to realize income by revocation at the settlor's option overcame the technical disposition. The 'nonmaterial satisfaction' (gifts-contributions) of a donor are not taxable as income. **Helvering v. Horst,** supra."

The pleasures and satisfactions derivable by petitioner from his control of the trusts were nonmaterial satisfactions which are not the equivalent of economic benefit or

gain. The decision conflicts with **Helvering v. Stuart** and this Court should resolve the conflict.

The decision in this case is that the pleasures and satisfactions derived by petitioner from control of the trust property constitutes **income** within the meaning of the Sixteenth Amendment to the Constitution of the United States. The ruling cannot be reconciled with the decision of this Court in **Eisner v. Macomber**, 252 U. S. 189, 40 Sup. Ct. R. 189, where income was defined as follows:

> "* * * a gain, a profit, something of exchangeable value, **proceeding from** the property, **severed from** the capital, however invested or employed, and **coming in,** being **'derived'**—that is **received** or **drawn by** the recipient (the taxpayer) for his **separate** use, benefit and disposal—**that** is income derived from property. Nothing else answers the description."

Neither the Tax Court nor the Court of Appeals attempted to say that petitioner could make personal use of either income or principal of these trusts. The decision seems to be in direct conflict with **Eisner v. Macomber,** which holds that **income** within the meaning of the Sixteenth Amendment of the United States means something coming in for personal use. To tax petitioner upon the control he exercises over corpus and income of these trusts is a tax upon his right to act as trustee of the trusts and imposes a tax upon the right to act as trustee without apportionment among the several states and without regard to any census or enumeration, and violates Article I, Section 2, Clause 3, of the Constitution, which provides that direct taxes shall be apportioned among the several states according to their respective numbers.

The Circuit Court of Appeals found as a fact that:

> "All ten of the trusts were irrevocable and petitioner was not to receive corpus or income from any

of them. * * * The trusts were intended for petitioner's family and he was not to share in the income or get back any part of the corpus."

Under the laws of Missouri and also under the above finding by the Court of Appeals, if petitioner is forced to pay a tax in this case he could not recoup any part thereof from the trust estate. The trust corpus and income were fully, finally and definitely disposed of. The money to pay the tax must, therefore, come from petitioner's private property. This is in effect the levying of a tax on capital and has nothing whatever to do with income.

Moreover, if petitioner should meet with financial reverses and be forced into bankruptcy, where would the Government collect its tax on the trust income? Certainly Congress did not intend that trust income should escape taxation when the grantor of the trust had become insolvent. If the trust corpus could revert to the grantor as in the Clifford case, we would have an answer to our problem, but where the property is definitely disposed of, it must of necessity bear its burden of taxation, and that burden cannot be shifted to persons who might later in life become financially irresponsible.

After the Court of Appeals made the specific finding of fact referred to, it is clear that no tax could be constitutionally exacted from the petitioner in this case. The finding shows that the petitioner had permanently and definitively disposed of the corpora of the trusts and that he could not receive corpus or income from any of them. It is, therefore, plain that the income of the trusts would be taxable under Sections 161, 162 and 163 of the Internal Revenue Code, and not taxable to petitioner because it was not his income.

In the guise of an income tax, Congress would clearly have no right to tax as income of a taxpayer the income which the Court has definitely determined to be that of another taxpayer.

In the case of Hoeper v. Tax Commission, 284 U. S. 206, this Court said:

> "We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a state to measure the tax on one's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the Fourteenth Amendment. That which is not in fact the taxpayer's income cannot be made such by calling it income."

In the case of Heiner v. Donan, 285 U. S. 312, this Court said:

> "Plainly, this is to measure the tax on A's property by imputing to it, in part, the value of the property of B, a result which both the Schlesinger and Hoeper cases condemn as arbitrary and in denial of due process of law. Such an exaction is not taxation but spoliation. It is not taxation that Government should take from one the profits and gains of another. That is taxation which compels one to pay for the support of the Government from his own gains and his own property."

Later on in the opinion in the same case this Court said:

> "It is, therefore, a contribution to the Government exacted of one person, based pro tanto upon the wealth of another."

In the case at bar the proposed exaction of the tax from petitioner is based, not on the income from his property and not upon his income, but upon the income of ten irrevocable long-term trusts from which petitioner can never receive economic gain or benefit. The property was permanently disposed of. To shift the burden of the tax to the petitioner in this case would be so arbitrary and caparicious as to violate the Fifth Amendment to the Constitution of the United States by depriving petitioner of his property without due process of law.

III.

There Is an Important Question of Federal Law.

The ruling by the Court of Appeals that petitioner is economic owner of the trust property for tax purposes is a decision on an important question of federal law which has not been, but should be settled by this Court. It is a fact that many trust instruments such as these have been put into operation, and that the question of whether a grantor-trustee who can never receive corpus or income from a trust created by him, is one of great importance to the many individuals involved. A man of wealth who creates a trust and disposes of the bulk of his property for the benefit of his children may find himself a pauper as the result of the tax.

One criticism of the decision in this case is that it overrules the following Tax Court decisions:

Ayer v. Com., 45 B. T. A. 146;
Lowenstein v. Com., 3 T. C. 1133;
Small v. Com., 3 T. C. 1142;
Cherry v. Com., 3 T. C. 1141;
Banfield v. Com., 4 T. C. 6.

The above decisions were reviewed by the entire sixteen members of the Tax Court. They cover a period of time from 1941 to September, 1944, and constitute the Tax Court's best judgment on the question of taxation of trust income. After the decisions were rendered they were reviewed by the Commissioner of Internal Revenue and were acquiesced in by him. This acquiescence on the part of the Commissioner means that the Tax Court and the Commissioner are in complete accord on the principles settled by those cases. That is what tax practitioners know as an "administrative policy." This policy has long been settled in the Treasury Department and the decision in this case completely ignores this fact.

The principles which were settled by the above Tax Court decisions are:

(a) A grantor may act as trustee.

(b) Powers vested in a grantor-trustee are not the same as powers reserved by the grantor in his individual capacity.

(c) Broad powers vested in a trustee, even though without adverse interest, indicate complete lack of control in the grantor.

(d) Adult children living separate and apart from the grantor are not members of the grantor's family.

(e) Economic gain--as distinguished from non-material satisfactions—is necessary to produce taxable income.

The question is one of great complexity. Judge Johnsen, writer of the opinion in this case, said:

> "It is to be wished, of course, that the field opened up by the Clifford case may come to have some definite monuments, but the doctrinal state in which the matter has been left by the Supreme Court permits, for the present, of only a case by case progression 'to determine precisely where the line shall be drawn between gifts of income producing property and gifts of income from property of which the donor remains the owner, for all substantial and practical purposes'" (R. 118).

Judge Sanborn, in a concurring opinion, expresses the perplexity of everyone called upon to deal with this phase of tax law when he said:

> "The Tax Court decided that the income of the trust created by Louis Stockstrom was his income for purposes of taxation, under the doctrine of Helvering v. Clifford, 309 U. S. 331, regardless of the fact that he could not recapture either trust income or trust principal. The basis for the decision is that Stockstrom, as donor-trustee, retained such broad powers of control and distribution over trust corpus and income

that the income was taxable to him, although he could have none of it for his own use. I think the Tax Court might well have decided this case in favor of the taxpayer, but the standard for determining to whom the income was taxable is presently so vague and indefinite that I have no conviction as to whether the decision of the Tax Court is, as a matter of law, right or wrong. I therefore concur. I think it is unfortunate that courts which are required to determine such controversies as this must express opinions which are obviously little more than guesses. The number of cases in which the doctrine of Helvering v. Clifford, supra, is invoked indicates the difficulty which the Bench and Bar are having in applying that doctrine. See Shepard's United States Citations on 309 U. S. 331" (R. 119).

These frank statements of the judges are an appeal for clarification of these questions by this Court.

Helvering v. Clifford, 309 U. S. 331, is distinguishable from this case in every respect. There, the trust was for a short term of five years; here, the term is at least for the lives of the beneficiaries. There, the property reverted to petitioner in five years; here, no portion of corpora or income of the trust can ever revest in petitioner. There, petitioner reserved powers as an individual which, if exercised, would have destroyed the trust; here, petitioner's only powers are as trustee as limited by the laws of Missouri and the express provision of the trust instruments that he shall administer the trust property as he may deem best in the interests of the beneficiaries of the trust. There, the beneficiaries were petitioner's wife and children—his intimate family group; here, the beneficiaries are adult children and grandchildren with no legal claims on petitioner, and with separate residences apart from him. There, income of the trust was temporarily allocated to members of petitioner's immediate family; here, income of each trust is definitely and absolutely appropriated to a designated child or grandchild and his descendants There,

Clifford's control as an individual of the trust property during the trust and early reversion to him enabled him to realize economic gain from the trust property; here, the law forbids petitioner to realize any benefit from the trust property. There, one economic unit was divided into two; here, there is no division of an economic unit.

This Court should determine the question of whether the combination of broad administrative powers and control of income brings a trust within the doctrine of **Helvering v. Clifford.**

Furthermore, Article 166-1 of Treasury Regulations 86, were not promulgated under Section 22 (a) until two years after Clifford's tax liability accrued, and, therefore, were not considered by this Court in deciding Clifford's case. **Helvering v. Clifford,** 309 U. S. 331; Note p. 334. The regulations (set out in the Appendix) enumerate various types of trusts the income of which will be taxed under Section 22 (a), but do not purport to include long term trusts from which the grantor-trustee can never receive corpus or income. The doctrine of **Helvering v. Clifford,** as decided under Section 22 (a), should be reviewed by this Court under Section 22 (a) as affected by the regulations.

Conclusion.

The decision conflicts with decisions of the Circuit Courts of Appeals and of this Court, and presents questions of public importance which justify issuance of the writ.

Respectfully submitted,

THOMAS R. REYBURN,
Counsel for Petitioner.

CHASE MORSEY,
RICHARD A. AUSTIN,
Of Counsel.